

E-015/M-93-1051 ORDER EXTENDING PILOT PROJECT, REQUIRING FURTHER
FILINGS, AND AUTHORIZING WORKING GROUP

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of the Proposal of
Minnesota Power for Approval to
Continue its Demand Side
Management Financial Incentive
and Approval of a New Financial
Incentive

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DOCKET NO. E-015/M-93-1051

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PROCEDURAL HISTORY

On March 12, 1992 the Commission issued an Order establishing a two-year pilot project of demand side management financial incentives for Minnesota Power. The incentive package had two parts: (a) full recovery of margins lost due to energy savings achieved through successful Conservation Improvement Plan (CIP) projects and (b) a Double Shared Savings Incentive which split the financial savings from large, cost-effective conservation projects between ratepayers and shareholders. The pilot project was scheduled to expire on December 31, 1993. The Company was required to file an evaluation of the pilot project on April 30, 1994.

On October 21, 1993 the Company filed a request to continue the pilot project, but to replace the Double Shared Savings Incentive with a bonus return on its net after tax CIP tracker account balance. The bonus return would be two percent over and above the Company's 13.04% carrying charge.

The Department of Public Service (the Department) recommended that the Commission extend the pilot project for two years, eliminate the Double Shared Savings Incentive, reject the proposed bonus return, allow the Company to file a bonus proposal more closely linked to performance, and allow interested parties to recommend changes to the incentive package after reviewing the Company's April 1994 filing.

The Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG) urged the Commission to deny the Company's proposal for a bonus return on its CIP tracker, require more detailed information on the performance of

the existing financial incentives package, require the Company to consult with the RUD-OAG and the DSM (Demand Side Management) Evaluation Consortium in designing a study on free rider issues, and direct the Company to study the comparative advantages of shared savings projects and grant-based projects for large customers.

In its reply comments the Company asked the Commission to defer consideration of its proposal for a bonus return on its CIP tracker account, pending further discussions with other parties.

The matter came before the Commission on January 6, 1994.

FINDINGS AND CONCLUSIONS

I. Summary of Commission Action

The Commission will extend the financial incentive pilot project, minus the Double Shared Savings Incentive, through calendar year 1994 and will defer consideration of the bonus return proposal as requested by the Company. The Commission will require the Company to notify the Commission promptly of any changes in its plans for measuring energy savings or evaluating the pilot project.

The Commission will ask the Company to consult with the Department, the RUD-OAG, and the DSM Evaluation Consortium in preparing a study on free riders and other misattributions of efficiency gains. Finally, the Commission will authorize staff to convene a working group to help gather the information necessary to evaluate the performance of demand side management financial incentives in Minnesota over the past two years.

II. Pilot Project Extended

The Company said the part of the pilot project it seeks to retain, lost margin recovery, has resulted in significant demand side management gains and should be continued indefinitely. The Department favored continuing that part of the project for two years, subject to review in light of the Company's April 1994 lost margin and CIP tracker report.

The Commission agrees with the Company and the Department that the pilot project, apart from the Double Shared Savings Incentive, is producing results and should be continued while the Commission examines its overall value. The Commission reminds all parties, however, that demand side management financial incentives, including lost margin recovery, are a regulatory

experiment. The Order approving Minnesota Power's financial incentive pilot project made this clear:

The Commission concludes that it is in the public interest to establish financial incentives for Minnesota Power to invest in demand side management. By doing this, the Commission is not finding that financial incentives are in the public interest and should become a permanent part of electric utility ratemaking. It may turn out that financial incentives are useful primarily as devices to ease the transition from supply side management to a combination of supply side and demand side management. It may turn out that the role of financial incentives should be limited to encouraging utilities to find and implement the most cost effective conservation programs possible. For now, however, the Commission is convinced it is in the public interest to explore the potential of financial incentive programs designed by individual utilities to increase their individual use of demand side management.

In the Matter of the Proposal of Minnesota Power for a Demand-Side Management Financial Incentive, Docket No. E-015/M-91-458, ORDER ESTABLISHING DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS (March 12, 1992), at 5.

During 1994 the Commission will evaluate Minnesota Power's financial incentive pilot project, the performance of other utilities' pilot projects, and the proper role of financial incentives in today's regulatory environment. To avoid losing ground during this evaluation period, the Commission will extend the pilot project, minus the Double Shared Savings Incentive, for another year. To avoid prejudging the outcome of the evaluation proceeding, however, the Commission will not extend the pilot project beyond calendar year 1994.

Finally, the Commission will defer consideration of the bonus return proposal at the Company's request.

III. Existing Evaluation Proposal to be Followed

The RUD-OAG emphasized the need for rigor in evaluating the pilot project and analyzing the public policy issues raised by demand side management financial incentives. The agency questioned whether existing evaluation strategies were up to the task, especially strategies for measuring energy savings and cost-effectiveness. The agency proposed postponing Commission action on the Company's evaluation plans until the Department of Public

Service had acted on the Company's CIP filing, believing the Department's findings on Company proposals for measuring energy savings might be helpful.

The Company claimed existing evaluation plans were adequate, but urged the Commission to defer to the Department on measuring energy savings.

The Department opposed postponing Commission action on evaluation strategies, arguing that the purposes of CIP proceedings and financial incentive proceedings are different.

The Commission agrees with the Department that Department proceedings on CIP plans and Commission proceedings on financial incentives have different purposes and should proceed independently. While holding concurrent proceedings may cause some duplication, on the whole it will aid parties and decisionmakers by raising the level of understanding and discourse in both proceedings.

The Commission shares RUD-OAG's commitment to rigorous evaluation of individual financial incentive pilot projects and the future of financial incentives in Minnesota. The Commission has already considered and approved an evaluation plan for Minnesota Power,¹ however, and will not re-examine that issue in the absence of evidence that the approved plan is inadequate. The general concerns raised by the RUD-OAG do not warrant spending the resources necessary to reopen the evaluation issue.

At the same time, it is crucial that the Commission and all parties have a clear and accurate understanding of how the Company intends to measure energy savings and evaluate its pilot project. If the Company proposes to deviate from the approved plan in any way, it should include a detailed proposal and explanation in its annual April 30 project report.

IV. Free Ridership to be Addressed

The RUD-OAG urged the Commission to require the Company to study and report on the "free rider" issue as part of its project evaluation. Briefly, the free rider issue is how to treat behavior that qualifies for a reward but would have occurred anyway. Rewarding free riders makes incentive programs more expensive than they need to be, but identifying and excluding free riders on clearly equitable terms can be difficult.

¹ In the Matter of Minnesota Power's Demand Side Management Financial Incentive Pilot Program Compliance Filing, Docket No. E-015/M-91-458, ORDER APPROVING EVALUATION PLAN AND METHOD TO CALCULATE LOST MARGINS AND BONUS (August 21, 1992).

The Department and the Company agreed that free riders and other misattributions of efficiency gains merited study. Both the Department and the RUD-OAG offered to collaborate with the Company.

The Commission agrees a study would be helpful and will require the Company to perform one and report the results to the Commission. The Commission encourages the Company to work with the Department, the RUD-OAG, and the DSM Evaluation Consortium in designing and conducting the study.

V. Working Group Authorized

When it approved the Company's financial incentive pilot project, the Commission made it clear that financial incentives were innovative regulatory tools the Commission might or might not continue to use in the future. The task facing the Commission, then, is not just to evaluate Minnesota Power's pilot project but to evaluate the continued usefulness of financial incentives for all Minnesota electric utilities. To be successful, the second evaluation requires resources and perspectives beyond those of Minnesota Power and the Commission.

The Commission will therefore authorize its staff to convene a working group of interested persons to make recommendations to the Commission on what information is necessary to conduct a proper evaluation, to render its own evaluation of financial incentives' effect on utility behavior, and to make recommendations on the future of financial incentives in Minnesota. The Commission will also ask the working group to explore and report to the Commission on the issue raised by the failure of the Double Shared Savings Incentive: the comparative advantages of shared savings projects and grant-based projects for large customers.

In addition to Commission staff, the working group will include the four electric utilities operating financial incentive pilot projects, the Department, the RUD-OAG, and one or two stakeholders from the private or non-profit sectors. The experience and expertise of these parties will assist the Commission as it considers the future of financial incentives in Minnesota.

ORDER

1. Minnesota Power's demand side management financial incentives pilot project, minus the Double Shared Savings

Incentive, is extended from January 1, 1994 through December 31, 1994.

2. On or before April 30, 1994 the Company shall file a detailed explanation of any changes it proposes to make to its approved plans for measuring energy savings or evaluating the pilot project.
3. The Company shall design and conduct a study of free riders and other misattributions of efficiency gains. A detailed report on the study shall be filed as soon after its completion as possible. The Commission encourages the Company to consult with the RUD-OAG, the Department, and the DSM Evaluation Consortium in designing and conducting the study.
4. The Commission authorizes its staff to convene a working group to make recommendations to the Commission on what information is necessary to evaluate the two-year experiment with financial incentives, to render its own evaluation of financial incentives' effect on utility behavior, and to make recommendations on the future of financial incentives in Minnesota. The working group shall also report on the comparative advantages of shared savings projects and grant-based projects for large customers. The composition and charge of the working group shall be as described above.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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